election in the manner prescribed by appropriate instructions for the return filed for the taxable year of the sale.

(ii) *Election made after the due date.* Elections after the time specified in paragraph (d)(3)(i) of this section will be permitted only in those rare circumstances when the Internal Revenue Service concludes that the taxpayer had good cause for failing to make a timely election. A recharacterization of a transaction as a sale in a taxable year subsequent to the taxable year in which the transaction occurred (*e.g.*, a transaction initially reported as a lease later is determined to have been an installment sale) will not justify a late election. No conditional elections will be permitted. For a special transitional rule relating to certain taxable years for which a return is filed prior to February 19, 1981, see paragraph (d)(5) of this section.

(4) *Revoking an election.* Generally, an election made under paragraph (d)(1) is irrevocable. An election may be revoked only with the consent of the Internal Revenue Service. A revocation is retroactive. A revocation will not be permitted when one of its purposes is the avoidance of Federal income taxes, or when the taxable year in which any payment was received has closed. For a special transitional rule relating to certain taxable years for which a return is filed prior to February 19, 1981, see paragraph (d)(5) of this section.

(5) *Transitional rules.* The following transitional rules shall apply with respect to any contingent payment sale made after October 19, 1980 in a taxable year, ending after that date, for which the taxpayer has filed a federal income tax return prior to February 19, 1981. If in such tax return the taxpayer has treated the contingent payment sale under the installment method, consent of the Internal Revenue Service to a late election by the taxpayer not to report the transaction on the installment method will generally be granted if the request for election out of installment method treatment is filed by May 5, 1981. If in such tax return the taxpayer has elected not to report the contingent payment sale under the installment method, consent of the Service to revocation of the election by the taxpayer will generally be granted if the request for revocation is filed by May 5, 1981.

(e) *Purchaser evidences of indebtedness payable on demand or readily tradable—* (1) *Treatment as payment*—(i) *In general.* A bond or other evidence of indebtedness (hereinafter in this section referred to as an obligation) issued by any person and payable on demand shall be treated as a payment in the year received, not as installment obligations payable in future years. In addition, an obligation issued by a corporation or a government or political subdivision thereof—

(A) With interest coupons attached (whether or not the obligation is readily tradable in an established securities market),

(B) In registered form (other than an obligation issued in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or

(C) In any other form designed to render such obligation readily tradable in an established securities market,

shall be treated as a payment in the year received, not as an installment obligation payable in future years. For purposes of this paragraph, an obligation is to be considered in registered form if it is registered as to principal, interest, or both and if its transfer must be effected by the surrender of the old instrument and either the reissuance by the corporation of the old instrument to the new holder or the issuance by the corporation of a new instrument to the new holder.

(ii) *Examples.* The rules stated in this paragraph may be illustrated by the following examples:

Example (1). On July 1, 1981, A, an individual on the cash method of accounting reporting on a calendar year basis, transferred all of his stock in corporation X (traded on an established securities market and having a fair market value of $1,000,000) to corporation Y in exchange for 250 of Y's registered bonds (which are traded in an over-the-counter-market) each with a principal amount and fair market value of $1,000 (with interest payable at the rate of 12 percent per year), and Y's unsecured promissory note with a principal amount of $750,000. At the time of such exchange A's basis in the X stock is $900,000. The promissory note is payable at the rate of $75,000 annually, due on July 1 of each year following 1981 until the

principal balance is paid. The note provides for the payment of interest at the rate of 12 percent per year also payable on July 1 of each year. Under the rule stated in paragraph (e)(1)(i) of this section, the 250 registered bonds of Y are treated as a payment in 1981 in the amount of the value of the bonds, $250,000.

Example (2). Assume the same facts as in example (1). Assume further that on July 1, 1982, Y makes its first installment payment to A under the terms of the unsecured promissory note with 75 more of its $1,000 registered bonds. A must include $7,500 (*i.e.*, 10 percent gross profit percentage times $75,000) A's gross income for calendar year 1982. In addition, A includes the interest payment made by Y on July 1 in A's gross income for 1982.

(2) *Amounts treated as payment.* If under paragraph (e)(1) of this section an obligation is treated as a payment in the year received, the amount realized by reason of such payment shall be determined in accordance with the taxpayer's method of accounting. If the taxpayer uses the cash receipts and disbursements method of accounting, the amount realized on such payment is the fair market value of the obligation. If the taxpayer uses the accrual method of accounting, the amount realized on receipt of an obligation payable on demand is the face amount of the obligation, and the amount realized on receipt of an obligation with coupons attached or a readily tradable obligation is the stated redemption price at maturity less any original issue discount (as defined in section 1232(b)(1)) or, if there is no original issue discount, the amount realized is the stated redemption price at maturity appropriately discounted to reflect total unstated interest (as defined in section 483(b)), if any.

(3) *Payable on demand.* An obligation shall be treated as payable on demand only if the obligation is treated as payable on demand under applicable state or local law.

(4) *Designed to be readily tradable in an established securities market*—(i) *In general.* Obligations issued by a corporation or government or political subdivision thereof will be deemed to be in a form designed to render such obligations readily tradable in an established securities market if—

(A) Steps necessary to create a market for them are taken at the time of issuance (or later, if taken pursuant to an expressed or implied agreement or understanding which existed at the time of issuance),

(B) If they are treated as readily tradable in an established securities market under paragraph (e)(4)(ii) of this section, or

(C) If they are convertible obligations to which paragraph (e)(5) of this section applies.

(ii) *Readily tradable in an established securities market.* An obligation will be treated as readily tradable in an established securities market if—

(A) The obligation is part of an issue or series of issues which are readily tradable in an established securities market, or

(B) The corporation issuing the obligation has other obligations of a comparable character which are described in paragraph (e)(4)(ii)(A) of this section. For purposes of paragraph (e)(4)(ii)(B) of this section, the determination as to whether there exist obligations of a comparable character depends upon the particular facts and circumstances. Factors to be considered in making such determination include, but are not limited to, substantial similarity with respect to the presence and nature of security for the obligation, the number of obligations issued (or to be issued), the number of holders of such obligation, the principal amount of the obligation, and other relevant factors.

(iii) *Readily tradable.* For purposes of paragraph (e)(4)(ii)(A) of this section, an obligation shall be treated as readily tradable if it is regularly quoted by brokers or dealers making a market in such obligation or is part of an issue a portion of which is in fact traded in an established securities market.

(iv) *Established securities market.* For purposes of this paragraph, the term ''established securities market'' includes (A) a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f), (B) an exchange which is exempted from registration under section 5 of the Securities Exchange Act of 1934 (15 U.S.C. 78e) because of the limited volume of transactions, and (c) any over-the-counter market. For purposes of this (iv), an

over-the-counter market is reflected by the existence of an interdealer quotation system. An interdealer quotation system is any system of general circulation to brokers and dealers which regularly disseminates quotations of obligations by identified brokers or dealers, other than a quotation sheet prepared and distributed by a broker or dealer in the regular course of business and containing only quotations of such broker or dealer.

(v) *Examples.* The rules stated in this paragraph may be illustrated by the following examples:

Example (1). On June 1, 1982, 25 individuals owning equal interests in a tract of land with a fair market value of $1 million sell the land to corporation Y. The $1 million sales price is represented by 25 bonds issued by Y, each having a face value of $40,000. The bonds are not in registered form and do not have interest coupons attached, and, in addition, are payable in 120 equal installments, each due on the first business day of each month. In addition, the bonds are negotiable and may be assigned by the holder to any other person. However, the bonds are not quoted by any brokers or dealers who deal in corporate bonds, and, furthermore, there are no comparable obligations of Y (determined with reference to the characteristics set forth in paragraph (e)(2) of this section) which are so quoted. Therefore, the bonds are not treated as readily tradable in an established securities market. In addition, under the particular facts and circumstances stated, the bonds will not be considered to be in a form designed to render them readily tradable in an established securities market. The receipt of such bonds by the holder is not treated as a payment for purposes of section 453(f)(4), notwithstanding that they are freely assignable.

Example (2). On April 1, 1981, corporation M purchases in a casual sale of personal property a fleet of trucks from corporation N in exchange for M's negotiable notes, not in registered form and without coupons attached. The M notes are comparable to earlier notes issued by M, which notes are quoted in the Eastern Bond section of the National Daily Quotation Sheet, which is an interdealer quotation system. Both issues of notes are unsecured, held by more than 100 holders, have a maturity date of more than 5 years, and were issued for a comparable principal amount. On the basis of these similar characteristics it appears that the latest notes will also be readily tradable. Since an interdealer system reflects an over-the-counter market, the earlier notes are treated as readily tradable in an established securities market. Since the later notes are obligations comparable to the earlier ones, which are treated as readily tradable in an established securities market, the later notes are also treated as readily tradable in an established securities market (whether or not such notes are actually traded).

(5) *Special rule for convertible securities*—(i) *General rule.* If an obligation contains a right whereby the holder of such obligation may convert it directly or indirectly into another obligation which would be treated as a payment under paragraph (e)(1) of this section or may convert it directly or indirectly into stock which would be treated as readily tradable or designed to be readily tradable in an established securities market under paragraph (e)(4) of this section, the convertible obligation shall be considered to be in a form designed to render such obligation readily tradable in an established securities market unless such obligation is convertible only at a substantial discount. In determining whether the stock or obligation into which an obligation is convertible is readily tradable or designed to be readily tradable in an established securities market, the rules stated in paragraph (e)(4) of this section shall apply, and for purposes of such paragraph (e)(4) if such obligation is convertible into stock then the term ''stock'' shall be substituted for the term ''obligation'' wherever it appears in such paragraph (e)(4).

(ii) *Substantial discount rule.* Whether an obligation is convertible at a substantial discount depends upon the particular facts and circumstances. A substantial discount shall be considered to exist if at the time the convertible obligation is issued, the fair market value of the stock or obligation into which the obligation is convertible is less than 80 percent of the fair market value of the obligation (determined by taking into account all relevant factors, including proper discount to reflect the fact that the convertible obligation is not readily tradable in an established securities market and any additional consideration required to be paid by the taxpayer). Also, if a privilege to convert an obligation into stock or an obligation which is readily tradable in an established securities market may not be exercised within a period of one year from the date the

obligation is issued, a substantial discount shall be considered to exist.

(6) *Effective date.* The provisions of this paragraph (e) shall apply to sales or other dispositions occurring after May 27, 1969, which are not made pursuant to a binding written contract entered into on or before such date. No inference shall be drawn from this section as to any questions of law concerning the application of section 453 to sales or other dispositions occurring on or before May 27, 1969.

[T.D. 7768, 46 FR 10709, Feb. 4, 1981; 46 FR 13688, Feb. 24, 1981; 46 FR 43036, Aug. 26, 1981, as amended by T.D. 7788, 46 FR 48920, Oct. 5, 1981; T.D. 8535, 59 FR 18751, Apr. 20, 1994]

§ 15a.453–2 Installment obligations received as liquidating distribution. [Reserved]

PART 16—TEMPORARY REGULATIONS UNDER THE REVENUE ACT OF 1962

AUTHORITY: Sec. 7805, 68 Stat. 917; 26 U.S.C. 7805.

§ 16.3–1 Returns as to the creation of or transfers to certain foreign trusts.

(a) *Requirement of return.* Every United States person who, on or after October 16, 1962, either creates a foreign trust or transfers money or property to a foreign trust, directly or indirectly, shall file an information return on Form 3520, except as provided in subparagraph (4) of paragraph (d) of this section. The return must be filed by the grantor or the transferor, or the fiduciary of the estate in the case of a testamentary trust. The return must be filed whether or not any beneficiary is a United States person and whether or not the grantor or any other person may be treated as the substantial owner of any portion of the trust under sections 671–678.

(b) *Meaning of terms.* For purposes of this section the following terms shall have the meaning assigned to them in this paragraph:

(1) *Foreign trust.* See section 7701(a)(31) of the Code for the definition of foreign trust.

(2) *United States person.* See section 7701(a)(30) of the Code for the definition of United States person.

(3) *Grantor.* The term ''grantor'' refers to any United States person who by an inter vivos declaration or agreement creates a foreign trust.

(4) *Transferor.* The term ''transferor'' refers to any United States person, other than a person who is the grantor or the fiduciary (as defined in subparagraph (5) of this paragraph), who transfers money or property to or for the benefit of a foreign trust. It does not refer to a person who transfers money or property to a foreign trust pursuant to a sale or an exchange which is made for full and adequate consideration.

(5) *Fiduciary of an estate.* In the case of a testamentary trust expressed in the will of a decedent the term ''fiduciary of an estate'' refers to the executor or administrator who is responsible for establishing a foreign trust on behalf of the decedent.

(c) *Information required.* The return required by section 6048 and this section shall be made on Form 3520 and shall set forth the following information:

(1) The name, address, and identifying number of the person (or persons) filing the return, a statement identifying each person named as either a grantor, fiduciary of an estate, or transferor, and the date of the transaction for which the return is being filed;

(2) In the case of a fiduciary of an estate, the name and identifying number of the decedent;

(3) The name of the trust and the name of the country under whose laws the foreign trust was created;

(4) The date the foreign trust was created and the name and address of the person (or persons) who created it;

(5) The date on which the trust is to terminate or a statement describing the conditions which will cause the trust to terminate;

(6) The name and business address of the foreign trustee (or trustees);

(7) A statement either that the trustee is required to distribute all of the trust's income currently (in which case the information required in subparagraph (c)(9) of this paragraph need not be furnished) or a statement that the

trust may accumulate some or all of its income;

(8) The name, address, and identifying number, if any, of each beneficiary who is either named in the instrument or whose identity is definitely ascertainable at the time the return required by this section is filed, and the date of birth for each beneficiary who is a United States person and whose rights under the trust are determined, in whole or in part, by reference to the beneficiary's age;

(9) Except as provided in subparagraph (c)(7) of this paragraph, a statement with respect to each beneficiary setting forth his right to receive income or corpus, or both, from the trust, his proportionate interest, if any, in the income or corpus, or both, of the trust, and any condition governing the time when a distribution to him may be made, such as a specific date or age (or in lieu of such statement a copy of the trust instrument which must be attached to the return);

(10) A detailed list of the property transferred to the foreign trust in the transaction for which the return is being filed, containing a complete description of each item transferred, its adjusted basis and its fair market value on the date transferred, and the consideration, if any, paid by the foreign trust for such transfer; and

(11) The name and address of the person (or persons) having custody of the books of account and records of the foreign trust, and the location of such books and records if different from such address.

(d) *Special provisions*—(1) *Separate return for each foreign trust and each transfer.* If a United States person creates more than one foreign trust or transfers money or property to more than one foreign trust, then separate returns must be filed with respect to each foreign trust where returns are required under section 6048 and this section. If a United States person transfers money or property to the same foreign trust at different times, then separate returns must be filed with respect to each transfer where returns are required under section 6048 and this section. However, where more than one transfer to the same foreign trust is made by a United States person during any 90-day period, such person may, at his election, file a single return, so long as the return includes the information required with respect to each transfer and is filed on or before the 90th day after the earliest transfer in any such period.

(2) *Joint returns.* Where returns are required under section 6048 and this section by two or more persons who either jointly create a foreign trust or jointly transfer money or property to a foreign trust, they may jointly execute and file one return in lieu of filing several returns.

(3) *Actual ownership of money or property transferred.* If any person referred to in this section is not the real party in interest as to the money or property transferred but is merely acting for a United States person, the information required under this section shall be furnished in the name of and by the actual owner of such money or property, except that a fiduciary of an estate shall file information relating to the decedent.

(4) *Payments to an employees' trust, etc.* In the case of contributions made to a foreign trust under a plan which provides pension, profit-sharing, stock bonus, sickness, accident, unemployment, welfare, or similar benefits or a combination of such benefits for employees, neither employers nor employees shall be required to file a return as set forth in this section.

(e) *Time and place for filing return*—(1) *Time for filing.* Any return required by section 6048 and this section shall be filed on or before the 90th day after either the creation of any foreign trust by a United States person or the transfer of any money or property to a foreign trust by a United States person. The Director of International Operations is authorized to grant reasonable extensions of time to file returns under section 6048 and this section in accordance with the applicable provisions of section 6081(a) and §1.6081–1.

(2) *Place for filing.* Returns required by section 6048 and this section shall be filed with the Director of International Operations, Internal Revenue Service, Washington D.C. 20225.

(f) *Penalties*—(1) *Criminal.* For criminal penalties for failure to file a return see section 7203. For criminal penalties

for filing a false or fraudulent return, see sections 7206 and 7207.

(2) *Civil.* For civil penalty for failure to file a return or failure to show the information required on a return under this section, see section 6677.

[T.D. 6632, 28 FR 277, Jan. 10, 1963]

PART 16A—TEMPORARY INCOME TAX REGULATIONS RELATING TO THE PARTIAL EXCLUSION FOR CERTAIN CONSERVATION COST-SHARING PAYMENTS

Sec.

AUTHORITY: Secs. 126 and 7805 of the Internal Revenue Code of 1954 (92 Stat. 2888, 26 U.S.C. 126; 68A Stat. 917, 26 U.S.C. 7805).

SOURCE: T.D. 7778, 46 FR 27637, May 21, 1981, unless otherwise noted.

§ 16A.126–0 Effective dates.

These temporary regulations shall apply to any payments received under a contract signed by the taxpayer and the appropriate agency after September 30, 1979.

§ 16A.126–1 Certain cost-sharing payments—in general.

(a) *Introduction.* In general, section 126 provides that recipients of payments made after September 30, 1979 under certain conservation, reclamation and restoration programs may exclude all or a portion of those payments from income if the payments do not substantially increase the annual income derived by the taxpayer from the affected property. For purposes of this section, the term ''payment'' as used in section 126 means payment of the economic benefit, if any, conferred upon the taxpayer upon receipt of the improvement. An increase in annual income is substantial if it exceeds the greater of 10 percent of the average annual income derived from the affected property prior to receipt of the improvement or an amount equal to $2.50 times the number of affected acres. The amount of gross income which a taxpayer realizes upon the receipt of a section 126 payment is the value of the section 126 improvement, reduced by the sum of the excludable portion and the taxpayer's share of the cost of the improvement (if any).

(b) *Definitions.* For purposes of this section, the term:

(1) ''Cost of the improvement'' means the sum of amounts paid by a government and the taxpayer, whether or not with borrowed funds, for the improvement.

(2) ''Section 126 cost'' means the cost of the improvement less the sum of

(i) Any government payments under a program which is not listed in section 126(a),

(ii) Any portion of a government payment under a program which is listed in section 126(a) which the Secretary of Agriculture has not certified is primarily for purposes of conservation,

(iii) Any government payment to the taxpayer which is in the nature of rent or compensation for services.

(3) ''Value of the section 126 improvement'' means the fair market value of the improvement multiplied by a fraction, the numerator of which is the section 126 cost and the denominator of which is the cost of the improvement.

(4) ''Affected acreage'' means the acres affected by the improvement.

(5) ''Excludable portion'' means the present fair market value of the right to receive annual income from the affected acreage of the greater of 10 percent of the prior average annual income from the affected acreage or $2.50 times the number of affected acres.

(6) ''Prior average annual income'' means the average of the gross receipts from the affected acreage for the last three taxable years preceding the taxable year in which installation of the improvement is commenced.

(7) ''Section 126 improvement'' means the portion of the improvement equal to the percentage which government payments made to the taxpayer, which the Secretary of Agriculture has certified were made primarily for the purpose of conservation, bear to the cost of the improvement.

(c) *Income realized upon receipt of a section 126 improvement*—(1) *Section 126 exclusion applied.* Unless a taxpayer

elects not to have section 126 apply, the amount of gross income realized on receipt of the section 126 improvement is the value of the section 126 improvement less the sum of the taxpayer's share of the cost of the improvement and the excludable portion.

(2) *Section 126 exclusion not applied.* If a taxpayer elects under section 126(c) not to have section 126 apply in whole or in part, the amount realized on the receipt of the section 126 improvement is the value of the section 126 improvement less the sum of the taxpayer's share of the cost of the improvement and the excludable portion that applies, if any.

(d) *Payments under watershed programs*—(1) *Programs within section 126(a)(9).* Section 126(a)(9) covers certain programs affecting small watersheds.

These programs must be administered by the Secretary of Agriculture and be determined by the Commissioner to be substantially similar to the type of program described in section 126(a) (1) through (8). The Commissioner has determined that section 126 improvements made in connection with small watersheds are within the scope of section 126(a)(9) if they are made under one of the following programs:

(A) The Watershed Protection and Flood Prevention Act, Pub. L. 566, 68 Stat. 666, as amended (16 U.S.C. 1001, *et seq.*), as funded by the Act of November 9, 1979, Pub. L. 96–108, 93 Stat. 834.

(B) Flood Prevention Projects, Pub. L. 86–468, sec. 1, 74 Stat. 131, as amended (16 U.S.C. 1006a); Pub. L. 78–534, sec. 2, 58 Stat. 889 (33 U.S.C. 701a–1); Pub. L. 78–534, sec. 13, 58 Stat. 905;

(C) Emergency Watershed Protection, Pub. L. 81–516, sec. 216, 64 Stat. 184 (33 U.S.C. 701b–1), and

(D) Colorado River Basin Salinity Control Act, Pub. L. 93–320, 88 Stat. 266:

(1) Title 1—Programs downstream from Imperial Dam, and

(2) Title 2—Measures upstream from Imperial Dam.

(2) *Other programs.* The Commissioner may announce further determinations under section 126(a)(9) from time to time in the Internal Revenue Bulletin.

(3) *Small watershed defined.* A watershed is a ''small watershed'' under this paragraph and section 126(a)(9) if the watershed or subwatershed does not exceed 250,000 acres and does not include any single structure providing more than 12,500 acre-feet of floodwater detention capacity, nor more than 25,000 acre-feet of total capacity.

(e) *Basis of property not increased by reason of excludable amounts.* Notwithstanding any provision of section 1016 (relating to adjustments to basis) to the contrary, basis of any property does not include any amount which is excludable from gross income under section 126.

(f) *Cross reference.* For rules relating to the recapture as ordinary income of the gain from the disposition (within 20 years of the date of receipt) of property for which an exclusion is claimed for a section 126 improvement, see section 1255 and the regulations thereunder.

(g) *Examples.* The provisions of this section are illustrated by the following examples:

Example (1). In 1981, 100 acres of the taxpayer's land is reclaimed under a Rural Abandoned Mine Program contract with the Soil Conservation Service of the U.S. Department of Agriculture. The total cost of the improvement is $700,000. USDA pays $690,000, the taxpayer $10,000. The Secretary of Agriculture certifies that 95% of the $690,000 USDA payment was primarily for the purpose of conservation. Therefore, $34,500 ($690,000×.05) is a nonsection 126 payment. $150,000 of USDA's payment is compensation for the taxpayer's service in the reclamation project and is includable in gross income as compensation for services. The taxpayer has $20,000 of allowable deductions in 1981, $15,500 of which are properly attributable to the USDA payment. Based on all the facts and circumstances, the value of the improvement is $21,000. The taxpayer elects not to have section 126 apply. The taxpayer computes the amount which is included in gross income as a result of receipt of the improvement as follows:

(1)

Cost of improvement	$700,000
Nonsection 126 payment	(34,500)
Compensation for services	(150,000)
Current deductions	(15,500)
Section 126 cost	500,000

(2)

Value of improvement	21,000
Multiplied by section 126 cost	×500,000
Cost of improvement	700,000

Value of section 126 improvement	15,000

(3)

Value of section 126 improvement	15,000
(Taxpayer's contribution)	10,000
Amount included in gross income	5,000

Example (2). The facts are the same as example (1) except that section 126 applies. Based on all the facts and circumstances, the present fair market value of the right to receive annual income from the property of 10 percent of the prior average annual income of the affected acreage prior to the receipt of the improvement is $1,380 and the present fair market value of the right to receive $250 ($2.50×100 acres) is $1,550. The excludable portion is, therefore, $1,550. The taxpayer computes the amount included in gross income as follows:

Value of section 126 improvement	$15,000
(Taxpayer's contribution)	(10,000)
(Excludable portion)	(1,550)
Amount included in income	3,450

Example (3). The facts are the same as example (2) except that the present value of 10 percent of the prior average annual income is $5,600. The taxpayer realizes no income as a result of receipt of the section 126 project.

(1)

Value of section 126 improvement	$15,000
(Taxpayer's contribution)	(10,000)
(Excludable portion)	(5,600)
Amount included in income	0

Example (4). In 1983, the taxpayer signs a contract under the water bank program under which he will maintain 20 acres of undisturbed wetlands as a wildfowl preserve. In return he will receive $90 an acre as rent from the government. Although the payment is made under a program listed in section 126(a) and the Secretary of Agriculture has certified that the entire amount of payment was made primarily for the purpose of conservation, there is no income eligible for section 126 exclusion because the full payment is rent. The rent is included in full in gross income.

Example (5). In 1980, the taxpayer reforests 200 acres of nonindustrial private forest land by planting tree seedlings. The taxpayer pays the full cost of the reforestation, $15,000. Under the cost-sharing provisions of the forestry incentives program, the taxpayer receives a reimbursement from USDA of $12,000. The Secretary of Agriculture certifies that 100% of the USDA payment is primarily for the purpose of conservation. Assume that the excludable portion is $3,500 and that based on all the facts and circumstances, the value of the improvement is $15,000. The amount which is includable in income is the value of the section 126 improvement, reduced by the excludable portion and the taxpayer's share of the cost of the improvement. Therefore the taxpayer includes $8,500 in gross income as a result of the USDA payment, computed as follows:

Value of the section 126 improvement	$15,000
(Excludable portion)	(3,500)
(Taxpayer's contribution)	(3,000)
Amount included in gross income	8,500

[T.D. 7748, 46 FR 27637, May 21, 1981; 46 FR 41043, Aug. 14, 1981]

§ 16A.126–2 Section 126 elections.

(a) *Election for section 126 not to apply in whole or in part.* A taxpayer may elect under section 126(c) not to have section 126 apply to all or any part of an improvement described in section 126.

(b) *Application of the section 126 exclusion.* To the extent the section 126 exclusion applies, the taxpayer should so indicate on an attachment to the tax return (or amended return) for the taxable year in which the taxpayer received the last payment made by a government for the improvement. The attachment should state the dollar amount of the section 126 cost funded by a government payment, the value of the section 126 improvement, and the amount that the taxpayer is excluding under section 126.

§ 16A.1255–1 General rule for treatment of gain from disposition of section 126 property.

(a) *Ordinary income*—(1) *General rule.* Except as otherwise provided in this section and § 16A.1255–2, if section 126 property is disposed of after September 30, 1979, then under section 1255(a)(1) there shall be recognized as ordinary income the lesser of—

(i) The ''excludable portion'' under section 126, or

(ii)(A) The excess of the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of the section 126 property (in the case of any other disposition), over the adjusted basis of the property, less

(B) The amount recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code.

(2) *Application of section.* Any gain treated as ordinary income under section 1255(a)(1) shall be recognized as ordinary income notwithstanding any other provision of subtitle A of the Code except that section 1255 does not apply to the extent the gain is recognized as ordinary income under the other provisions of Subchapter P, Part IV of the Code. For special rules with respect to the application of section 1255, see §16A.1255–2. For the relation of section 1255 to other provisions, see paragraph (c) of this section.

(3) *Meaning of terms.* For purposes of section 1255 and these regulations—

(i) The term ''section 126 property'' means any property acquired, improved, or otherwise modified as a result of a payment listed in section 126(a) which has been certified by the Secretary of Agriculture as primarily for the purpose of conservation;

(ii) The term ''excludable portion'' is defined in §16A.126–1(b)(5);

(iii) The term ''disposition'' has the same meaning as in §1.1245–1(a)(3);

(iv) The term ''date of receipt of the section 126 payment'' means the last date the government made a payment for the improvements.

(4) *Applicable percentage.* If section 126 property is disposed of less than 10 years after the date of receipt of the last payment which has been certified by the Secretary of Agriculture as primarily for the purpose of conservation, the ''applicable percentage'' is 100 percent; if section 126 property is disposed of more than 10 years after that date, the applicable percentage is 100 percent reduced (but not below zero) by 10 percent for each year or part thereof in excess of 10 years such property was held after the date of the section 126 payment.

(5) *Portion of parcel.* The amount of gain to be recognized as ordinary income under section 1255(a)(1) shall be determined separately for each parcel of section 126 property in a manner consistent with the principles of §1245–1(a) (4) and (5) relating to gain from disposition of certain depreciable property. If (i) only a portion of a parcel of section 126 property is disposed of in a transaction, or if two or more portions of a single parcel are disposed of in one transaction, and (ii) the aggregate of ''excludable portions'' with respect to any such portion cannot be established to the satisfaction of the Commissioner, then the aggregate of the ''excludable portions'' in respect of the entire parcel shall be allocated to each portion in proportion to the fair market value of each at the time of the disposition.

(b) *Instances of nonapplication*—(1) *In general.* Section 1255 does not apply if a taxpayer disposes of section 126 property more than 20 years after receipt of the last section 126 payment with respect to the property.

(2) *Losses.* Section 1255(a)(1) does not apply to losses. Thus, section 1255(a)(1) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of property, all of which is section 126 property, nor does the section apply to a disposition of the property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of the property is not greater than its adjusted basis.

(c) *Relation of section 1255 to other provisions*—(1) *General.* The provisions of section 1255 apply notwithstanding any other provisions of Subtitle A of the Code except that they do not apply to the extent gain is recognized as ordinary income under the other provisions of Subchapter P, Part IV of the Code. Thus, unless an exception or limitation under §16A.1255–2 applies, gain under section 1255(a)(1) is recognized notwithstanding any contrary nonrecognition provision or income characterizing provision. For example, since section 1255 overrides section 1231 (relating to property used in the trade or business), the gain recognized under section 1255 upon a disposition of section 126 property will be treated as ordinary income and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of property to which section 1231 applies. See example (1) of paragraph (d) of this section.

(2) *Nonrecognition sections overridden.* The nonrecognition of gain provisions of Subtitle A of the Code which section 1255 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337,

and 512(b)(5). See § 16A.1255–2 for the extent to which section 1255(a)(1) overrides sections 332, 351, 361, 371(a), 374(a), 721, 731, 1031, and 1033.

(3) *Installment method.* Gain from a disposition to which section 1255(a)(1) applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such a case, the portion of the installment payment that is gain is treated as follows: first as ordinary gain under other sections of Chapter I Subchapter P, Part IV of the Code until all that gain has been reported; next as ordinary gain to which section 1255 applies until all that gain is reported; and finally as gain under other sections of Chapter I, Subchapter D, Part IV of the Code. For treatment of amounts as interest on certain deferred payments, see section 483.

(4) *Exempt income.* With regard to exempt income, the principles of § 1.1245–6(e) shall be applicable.

(5) *Treatment of gain not recognized under section 1255(a)(1).* For treatment of gain not recognized under this section, the principles of § 1.1245–6(f) shall be applicable.

(d) *Example.* The provisions of this section may be illustrated by the following example:

Example (1). Individual A uses the calendar year as his taxable year. On April 10, 1995, A sells for $75,000 section 126 property with an adjusted basis of $52,500 for a realized gain of $22,500. The excludable portion under section 126 was $18,000. A received the section 126 payment on January 5, 1990. No gain is recognized as ordinary gain under sections 1231 through 1254. Because the applicable percentage, 100 percent, of the aggregate of the section 126 improvements ($18,000), $18,000, is lower than the gain realized, $22,500, the amount of gain recognized as ordinary income under section 1255(a)(1) is $18,000. The remaining $4,500 of the gain may be treated as gain from the sale or exchange of property described in section 1231.

§ 16A.1255–2 Special rules.

(a) *Exception for gifts*—(1) *General rule.* In general, no gain shall be recognized under section 1255(a)(1) upon a disposition of section 126 property by gift. For purposes of section 1255 and this paragraph, the term ''gift'' shall have the same meaning as in § 1.1245–4(a) and, with respect to the application of this paragraph, principles illustrated by the examples of § 1.1245–4(a)(2) shall apply.

(2) *Disposition in part a sale or exchange and in part a gift.* Where a disposition of section 126 property is in part a sale or exchange and in part a gift, the amount of gain which shall be recognized as ordinary income under section 1255(a)(1) shall be computed under § 16A.1255–1(a)(1), applied by treating the gain realized (for purposes of § 16A.1255–1(a)(1)(ii)), as the excess of the amount realized over the adjusted basis of the section 126 property.

(3) *Treatment of section 126 property in hands of transferee.* See paragraph (d) of this section for treatment of the transferee in the case of a disposition to which this paragraph applies.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). On March 2, 1986, A makes a gift to B of a parcel of land having an adjusted basis of $40,000 and fair market value of $65,000. On the date of that gift, the aggregate of excludable portions under section 126 was $24,000. The section 126 payments were all received on January 15, 1981. Upon making the gift, A recognizes no gain under section 1255(a)(1). See paragraph (a)(1) of this section. For treatment of the property in the hands of B, see example (1) of paragraph (d)(3) of this section.

Example (2). (i) Assume the same facts as in example (1), except that A transfers the land to B for $50,000. Assume further that no gain is recognized as ordinary income under any other provision of Chapter I, Subchapter P, Part IV of the Code. Thus, the gain realized is $10,000 (amount realized, $50,000, minus adjusted basis, $40,000), and A has made a gift of $15,000 (fair market value, $65,000, minus amount realized, $50,000).

(ii) Upon the transfer of the land to B, A recognizes $10,000 as ordinary income under section 1255(a)(1), computed under paragraph (a)(2) of this section as follows:

(1) Aggregate of excludable portions under section 126	$24,000
(2) Multiply: Applicable percentage for land disposed if within sixth year after section 126 payments were received	100
(3) Amount in § 16A.1255–1(a)(1)(i)	$24,000
(4) Gain realized (see (i) of this example)	10,000
(5) Amount in § 16A.1255–1(a)(1)(ii) applied in accordance with paragraph (a)(2) of this section	10,000
(6) Lower of line (3) or line (5)	10,000

Thus, the entire gain realized on the transfer, $10,000, is recognized as ordinary income.

For treatment of the farm land in the hands of B, see example (2) of paragraph (d)(3) of this section.

(b) *Exception for transfer at death*—(1) *In general.* Except as provided in section 691 (relating to income in respect of a decedent), no gain shall be recognized under section 1255(a)(1) upon a transfer at death. For purposes of section 1255 and this paragraph, the term ''transfer at death'' shall have the same meaning as in §1.1245–4(b) and, with respect to the application of this paragraph, principles illustrated by the examples of §1.1245–4(b)(2) shall apply.

(2) *Treatment of section 126 property in hands of transferee.* If, as of the date a person acquires section 126 property from a decedent, the person's basis is determined by reason of the application of section 1014(a), solely by reference to the fair market value of the property on the date of the decedent's death, or on the applicable date provided in section 2032 (relating to alternative valuation date), then on that date the aggregate of excludable portions under section 126 in the hands of such transferee is zero.

(c) *Limitation for certain tax-free transactions*—(1) *Limitation on amount of gain.* Upon a transfer of section 126 property described in paragraph (c)(2) of this section, the amount of gain recognized as ordinary income under section 1255(a)(1) shall not exceed an amount equal to the excess (if any) of (i) the amount of gain recognized to the transferor on the transfer (determined without regard to section 1255) over (ii) the amount (if any) of gain recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code. For purposes of paragraph (c)(1) of this section, the principles of §1.1245–4(c)(1) shall apply. Thus, in the case of a transfer of section 126 property and other property in one transaction, the amount realized from the disposition of the section 126 property (as determined in a manner consistent with the principles of §1.1245–1(a)(5)) shall consist of that portion of the fair market value of each property acquired which bears the same ratio to the fair market value of the acquired property as the amount realized from the disposition of the section 126 property bears to the total amount realized. The preceding sentence shall be applied solely for purposes of computing the portion of the total gain (determined without regard to section 1255) which is eligible to be recognized as ordinary income under section 1255(a)(1). The provisions of this paragraph do not apply to a disposition of property to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by Chapter I of the Code.

(2) *Transfers covered.* The transfers referred to in paragraph (c)(1) of this section are transfers of section 126 property in which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of any of the following provisions:

(i) Section 332 (relating to distributions in complete liquidation of an 80-percent-or-more controlled subsidiary corporation). For application of paragraph (c)(1) of this section to such a complete liquidation, the principles of §1.1245–4(c)(3) shall apply. Thus, for example, the provisions of paragraph (c)(1) of this section do not apply to a liquidating distribution of section 126 property by an 80-percent-or-more controlled subsidiary to its parent if the parent's basis for the property is determined, under section 334(b)(2), by reference to its basis for the stock of the subsidiary.

(ii) Section 351 (relating to transfer to a corporation controlled by the transferor).

(iii) Section 361 (relating to exchanges pursuant to certain corporate reorganizations).

(iv) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings).

(v) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations).

(vi) Section 721 (relating to transfers to a partnership in exchange for a partnership interest). See paragraph (e) of this section.

(vii) Section 731 (relating to distributions by a partnership to a partner). For special carryover of basis rule, see paragraph (e) of this section.

(viii) Section 1031 (relating to like kind exchanges).

(ix) Section 1034 (relating to rollover of gain on the sale of a principal residence).

(3) *Treatment of section 126 property in the hands of transferee.* See paragraph (d) of this section for treatment of the transferee in the case of a disposition to which this paragraph applies.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). On January 4, 1986, A holds a parcel of property that is section 126 property having an adjusted basis of $15,000 and a fair market value of $40,000. On that date he transfers the parcel to corporation M in exchange for stock in the corporation worth $40,000 in a transaction qualifying under section 351. On the date of the transfer, the aggregate of excludable portions under section 126 with respect to the transferred property is $18,000 and all of such amount was received on March 25, 1981. With regard to section 1255, A would recognize no gain under section 351 upon the transfer and M's basis for the land would be determined under section 362(a) by reference to its basis in the hands of A. Thus, as a result of the disposition, no gain is recognized as ordinary income under section 1255 by A since the amount of gain recognized under that section is limited to the amount of gain which is recognized under section 351 (determined without regard to section 1255). See paragraph (c)(1) of this section. For treatment of the section 126 property in the hands of B, see paragraph (d)(1) of this section.

Example (2). Assume the same facts in example (1), except that A transferred the property to M for stock in the corporation worth $32,000 and $8,000 cash. The gain realized is $25,000 (amount realized, $40,000, minus adjusted basis, $15,000). Without regard to section 1255, A would recognize $8,000 of gain under section 351(b). Assume further that no gain is recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code. Therefore, since the applicable percentage, 100 percent of the aggregate excludable portions under section 126, $18,000, is lower than the gain realized, $25,000, the amount of gain to be recognized as ordinary income under section 1255(a)(1) would be $18,000 if the provisions of paragraph (c)(1) of this section do not apply. Since under section 351(b) gain in the amount of $8,000 would be recognized to the transferor without regard to section 1255, the limitation provided in paragraph (c)(1) of this section limits the gain taken into account by A under section 1255(a)(1) to $8,000.

Example (3). Assume the same facts as in example (2), except that $5,000 of gain is recognized as ordinary income under section 1251(c)(1). The amount of gain recognized as ordinary income under section 1255(a)(1) is $3,000 computed as follows:

(1) Amount of gain under section 1255(a)(1) (determined without regard to paragraph (c)(1) of this section):	
(a) Aggregate of excludable portions under section 126	$18,000
(b) Multiply: Applicable percentage for property disposed of within the fifth year after section 126 payments were received (percent)	100
(c) Amount in § 16A.1255–1(a)(1)(i)	$18,000
(d) Gain realized (amount realized $40,000 less adjusted basis, $15,000)	$25,000
(e) Lower of line (c) or line (d)	$18,000
(2) Limitation in paragraph (c)(1) of this section:	
(a) Gain recognized (determined without regard to section 1255)	$8,000
(b) Minus: Gain recognized as ordinary income under section 1251(c)(1)	$5,000
(c) Difference	$3,000
(3) Lower of line (1)(e) or line (2)(c)	$3,000

Thus, the entire gain recognized under section 351(b) (determined without regard to sections 1251 and 1255), $8,000, is recognized as ordinary income since that amount is equal to the sum of the gain recognized as ordinary income under section 1251(c)(1), $5,000, and under section 1255(a)(1), $3,000.

(d) *Treatment of section 126 property received by a transferee in a disposition by gift and certain tax-free transactions*—(1) *General rule.* If section 126 property is disposed of in a transaction which is either a gift to which paragraph (a)(1) of this section applies, or a completely tax-free transfer to which paragraph (c)(1) of this section applies, then for purposes of section 1255—

(i) The aggregate of the excludable portions under section 126 in respect of the land in the hands of the transferee immediately after the disposition shall be an amount equal to the amount of such aggregate in the hands of the transferor immediately before the disposition, and

(ii) For purposes of applying section 1255 upon a subsequent disposition by the transferee (including a computation of the applicable percentage), the dates of receipt of section 126 payments shall not be affected by the dispositions.

(2) *Certain partially tax-free transfers.* If section 126 property is disposed of in a transaction which either is in part a sale or exchange and in part a gift to which paragraph (a)(2) of this section

applies, or is a partially tax-free transfer to which paragraph (c)(1) of this section applies, then for purposes of section 1255 the amount determined under paragraph (d)(1) of this section shall be reduced by the amount of gain taken into account under section 1255 by the transferor upon the disposition. Upon a subsequent disposition by the transferee, the dates of receipt of section 126 payments remain the same in the hands of the transferee as they were in the hands of the transferor. With respect to the 175 and 182 deductions taken by the transferee, the holding period shall not include the holding period of the transferor.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume the same facts as in example (1) of paragraph (a)(4) of this section. Therefore, on the date B receives the land in the gift transaction, under paragraph (d)(1) of this section the aggregate of excludable portions under section 126 in respect of the land in the hands of B is the amount in the hands of A, $24,000, and for purposes of applying section 1255 upon a subsequent disposition by B (including a computation of the applicable percentage) the date the section 126 payments were received is the same as it was when the property was in A's hands (January 15, 1981).

Example (2). Assume the same facts as in example (2) of paragraph (a)(4) of this section. Under paragraph (d)(2) of this section, the aggregate of excludable portions under section 126 which pass over to B for purposes of section 1255 is $14,000 ($24,000 excluded under section 126 minus $10,000 gain recognized under section 1255(d)(1) in accordance with example (2) of paragraph (a)(4) of this section). The date the section 126 payments were received is the same as when the property was in B's hands (January 15, 1981).

(e) *Disposition of section 126 property not specifically covered.* If section 126 property is disposed of in a transaction not specifically covered under § 16A.1255–1, and this section, then the principles of section 1245 shall apply.

PART 17—TEMPORARY INCOME TAX REGULATIONS UNDER 26 U.S.C. 103(c)

AUTHORITY: Sec. 7805 of the Internal Revenue Code of 1954; 68A Stat. 917 (26 U.S.C. 7805).

§ 17.1 Industrial development bonds used to provide solid waste disposal facilities; temporary rules.

(a) *In general.* Section 103(c)(4)(E) provides that section 103(c)(1) shall not apply to obligations issued by a State or local governmental unit which are part of an issue substantially all the proceeds of which are used to provide solid waste disposal facilities. Section 1.103–8(f) of this chapter provides general rules with respect to such facilities and defines such facilities. In the case of property which has both a solid waste disposal function and a function other than the disposal of solid waste, only the portion of the cost of the property allocable to the function of solid waste disposal (as determined under paragraph (b) of this section) is taken into account as an expenditure to provide solid waste disposal facilities. A facility which otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material or heat which has utility or value is recovered or results from the disposal process. Where materials or heat are recovered, the waste disposal function includes the processing of such materials or heat which occurs in order to put them into the form in which the materials or heat are in fact sold or used, but does not include further processing which converts the materials or heat into other products.

(b) *Allocation.* The portion of the cost of property allocable to solid waste disposal is determined by allocating the cost of such property between the property's solid waste disposal function and any other functions by any method which, with reference to all the facts and circumstances with respect to such property, reasonably reflects a separation of costs for each function of the property.

(c) *Example.* The principles of this paragraph may be illustrated by the following example:

Example. Company A intends to construct a new facility to process solid waste which City X will deliver to the facility. City X will pay a disposal fee for each ton of solid waste that City X dumps at the facility. The waste will be processed by A in a manner which separates metals, glass, and similar materials. As separated, some of such items are

commercially saleable; but A does not intend to sell the metals and glass until the metals are further separated, sorted, sized, and cleaned and the glass is pulverized. The metals and pulverized glass will then be sold to commercial users. The waste disposal function includes such processing of the metals and glass, but no further processing is included.

The remaining waste will be burned in an incinerator. Gases generated by the incinerator will be cleaned by use of an electrostatic precipitator. To reduce the size and cost of the electrostatic precipitator, the incinerator exhaust gases will be cooled and reduced in volume by means of a heat exchange process using boilers. The precipitator is functionally related and subordinate to disposal of the waste residue and is therefore property used in solid waste disposal. The heat can be used by A to produce steam. Company B operates an adjacent electric generating facility and B can use steam to power its turbine-generator. B needs steam with certain physical characteristics and as a result A's boilers, heat exchanger and related equipment are somewhat more costly than might be required to produce steam for some other uses. The disposal function includes the equipment actually used to put the heat into the form in which it is sold.

Company A intends to construct pipes to carry the steam from A's boiler to B's facility. When converted to such steam the heat is in the form in which sold, and therefore the disposal function does not include subsequent transporting of the steam by pipes. Similarly, if A installed generating equipment and used the steam to generate electricity, the disposal function would not include the generating equipment, since such equipment transforms the commercially saleable steam into another form of energy.

[T.D. 7362, 40 FR 26028, June 20, 1975]

PART 18—TEMPORARY INCOME TAX REGULATIONS UNDER THE SUBCHAPTER S REVISION ACT OF 1982

Sec.

AUTHORITY: 26 U.S.C. 7805.

SOURCE: T.D. 7872, 48 FR 3590, Jan. 26, 1983, unless otherwise noted.

§ 18.0 Effective date of temporary regulations under the Subchapter S Revision Act of 1982.

The temporary regulations provided under § 18.1377–1, 18.1379–1, and 18.1379–2 are effective with respect to taxable years beginning after 1982, and the temporary regulations provided under § 18.1378–1 are effective with respect to elections made after October 19, 1982.

[T.D. 8600, 60 FR 37588, July 21, 1995]

§ 18.1371–1 Election to treat distributions as dividends during certain post-termination transition periods.

A corporation may make an election under section 1371(e) (as amended by section 721(o) of the Act) to treat all distributions of money made during the post-termination transition period described in section 1377(b)(1)(A) as coming out of the corporation's earnings and profits (after earnings and profits have been eliminated, the distributions are applied against and reduce the adjusted basis of the stock). The election may be made only with the consent of each shareholder to whom the corporation makes a distribution (whether or not it is a cash distribution) during such post-termination transition period. Any such election shall be made by the corporation by attaching to its income tax return for the C year in which such post-termination transition period ends a statement which clearly indicates that the corporation elects to have section 1371(e)(1) not apply to all distributions made during such post-termination transition period. The election shall not be effective unless such statement is signed by a person authorized to sign the return required to be filed under section 6012 and by each shareholder required to consent to the election.

[T.D. 7976, 49 FR 35493, Sept. 10, 1984]

§ 18.1378–1 Taxable year of S corporation.

(a) *In general.* No corporation may make an election be an S corporation for any taxable year unless the taxable year is a permitted year. In addition, an S corporation shall not change its taxable year to any taxable year other than a permitted year. A permitted

year is a taxable year ending on December 31 or is any other taxable year for which the corporation establishes a business purpose (within the meaning of §1.442–1(b)(1)) to the satisfaction of the Commissioner.

(b) *Corporations qualifying for automatic change of taxable year to a taxable year ending December 31 and corporations adopting a taxable year ending December 31*—(1) *Qualification for automatic change.* Notwithstanding section 442 (relating to change of taxable year) and the regulations thereunder, a corporation may automatically change its taxable year to a taxable year ending on December 31 to comply with the permitted year requirement if all of its principal shareholders have taxable years ending on December 31, or if all of its principal shareholders concurrently change to such taxable year. A shareholder may not change his or her taxable year without securing prior approval from the Commissioner. See section 442 and the regulations thereunder. For purposes of this paragraph, a principal shareholder is a shareholder having 5% or more of the issued and outstanding stock of the corporation. See paragraph (d) of this section in the case where a corporation does not qualify under this subparagraph for an automatic change of its taxable year to a taxable year ending on December 31.

(2) *Effect of filing an election*—(i) *General rule.* The filing of an election to be an S corporation by a corporation that has, prior to making the election, adopted a taxable year ending other than on December 31, and that qualifies under paragraph (b)(1) of this section for an automatic change of its taxable year to a taxable year ending on December 31, shall constitute such automatic change for the first taxable year for which the election is effective. The filing of an election to be an S corporation by a corporation that has not, prior to making the election, adopted a taxable year shall constitute the adoption of a taxable year (or, if the corporation qualifies under paragraph (b)(1) of this section for the automatic change, the change to a taxable year) ending on December 31 for the first taxable year for which the election is effective. Where the taxable year has been changed pursuant to this subdivision and paragraph (b)(1) of this section, the first taxable year for which the election shall be effective shall commence on the first day of the first taxable year for which the election would have been effective if the taxable year had not been changed and shall end on December 31 of that taxable year. See §1.1362–6(b)(2)(ii) of this chapter for the time within which to make an election to be an S corporation.

(ii) *Request to retain (or adopt) a taxable year ending other than December 31.* A request to retain (or adopt) a taxable year ending other than on December 31 by a corporation subject to paragraph (b)(2)(i) of this section shall (except as provided in paragraph (b)(3)(ii) of this paragraph and in paragraph (c) of this section) be made on Form 2553 when the election to be an S corporation is filed. See §1.1362–6(b)(2)(i) of this chapter for the manner of making an election to be an S corporation. If such corporation receives permission to retain (or adopt) a taxable year ending other than on December 31, the election shall be effective and the provisions of paragraph (b)(2)(i) of this section shall be inapplicable. Denial of the request shall render the election ineffective unless—

(A) The request is accompanied by another request in which the corporation states that, in the event the request to retain (or adopt) a taxable year ending other than on December 31 is denied, it chooses to be governed by the provisions of paragraph (b)(2)(i) of this section, or

(B) The Commissioner waives the requirement to file the additional request described in paragraph (b)(2)(ii)(A) of this section and permits the corporation to be governed by the provisions of paragraph (b)(2)(i) of this section.

(c) [Reserved]

(d) *Elections by corporations not qualifying for automatic change.* An election to be an S corporation made after October 19, 1982, by a corporation that has a taxable year ending other than on December 31, and that does not qualify under paragraph (b)(1) of this section for an automatic change of its taxable year to a taxable year ending on December 31, shall be ineffective unless

the corporation has first secured a permitted year. At the request of a corporation wishing to secure a permitted year, the Commissioner shall make a determination that—

(1) The corporation's taxable year is a permitted year, or

(2) The corporation may, under §1.442–1(b)(1), change its taxable year to a taxable year ending on December 31, or

(3) The corporation may, under §1.442–1(b)(1), change its taxable year to a taxable year ending other than on December 31, which taxable year shall be a permitted year.

[T.D. 7872, 48 FR 3590, Jan. 26, 1983; 48 FR 33481, July 22, 1983, as amended by T.D. 8123, 52 FR 3623, Feb. 5, 1987; T.D. 8600, 60 FR 37589, July 21, 1995]

§ 18.1379–2 Transitional rules on enactment.

(a) *Prior elections.* Any election that was made under section 1372(a) (as in effect before the enactment of the Subchapter S Revision Act of 1982), and that is still in effect as of the first day of a taxable year beginning in 1983, shall be treated as being an election made under section 1362(a). In addition, any election that was made under section 1371(g)(2) (as in effect before the enactment of that Act), and that is still in effect as of the first day of a taxable year beginning in 1983, shall be treated as being an election made under section 1362(d)(2).

(b) *Prior terminations.* For purposes of section 1362(g), any termination under section 1372(e) (as in effect before the enactment of the Subchapter S Revision Act of 1982) shall not be taken into account.

(c) *Time and manner of making an election under section 6(c)(3)(B) of the Subchapter S Revision Act of 1982.* In the case of a qualified oil corporation (as defined in section 6(c)(3)(B) of the Subchapter S Revision Act of 1982), the corporation may elect under that section of the Act to have the amendments made by the Act not apply and to have Subchapter S (as in effect on July 1, 1982), Chapter I of the Internal Revenue Code of 1954 apply. The election shall be made by the corporation by filing a statement that—

(1) Contains the name, address, and taxpayer identification number of the corporation and of each shareholder,

(2) Identifies the election as an election under section 6(c)(3)(B) of the Subchapter S Revision Act of 1982, and

(3) Provides all information necessary in the judgment of the district director to show that the corporation meets the requirements (other than the requirement of making this election) of a qualified oil corporation.

The statement shall be signed by any person authorized to sign the return required to be filed under section 6037 and by each person who is or was a shareholder in the corporation at any time during the taxable year beginning in 1983 and shall be filed with the return for that taxable year.

§ 18.1379–2 Special rules for all elections, consents, and refusals.

(a) *Additional information required.* If later regulations issued under the section of the Code or of the Subchapter S Revision Act of 1982 under which the election, consent, or refusal was made require the furnishing of information in addition to that which was furnished with the statement of election, consent, or refusal as provided by part 18 of this title, and if an office of the Internal Revenue Service requests the taxpayer to provide the additional information, the taxpayer shall furnish the additional information in a statement filed with that office of the Internal Revenue Service within 60 days after the date on which the request is made. This statement shall also—

(1) Contain the name, address, and taxpayer identification number of each party identified in connection with the election, consent, or refusal,

(2) Identify the election, consent, or refusal by reference to the section of the Code or Act under which the election, consent, or refusal was made, and

(3) Specify the scope of the election, consent, or refusal.

If the additional information is not provided within 60 days after the date on which the request is made, the election, consent, or refusal may, at the discretion of the Commissioner, be held invalid.

(b) *State law incorporator.* For purposes of any election, consent, or refusal provided in part 18 of this title, any person who is considered to be a shareholder for state law purposes solely by virtue of his or her status as an incorporator shall not be treated as a shareholder.

PART 19—TEMPORARY REGULATIONS UNDER THE REVENUE ACT OF 1964

AUTHORITY: 26 U.S.C. 7805.

§19.3–1 Interest on certain deferred payments; interest rate for use in determining whether there is total unstated interest under a contract.

(a) *In general.* Section 224(a) of the Revenue Act of 1964 adds a new section 483 to the Internal Revenue Code of 1954. Section 483(a) provides, generally, that in the case of any contract for the sale or exchange of property (which is a capital asset or section 1231 property) there shall be treated as interest that part of a payment to which section 483 applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which such section applies which are due under the contract. Section 483(b) defines the term ''total unstated interest'', with respect to a contract for the sale or exchange of property, as an amount equal to the excess of—

(1) The sum of the payments to which section 483 applies which are due under the contract, over

(2) The sum of the present values of such payments and the present values of any interest payments due under the contract.

Section 483(b) further provides that, for purposes of section 483(b)(2), the present value of a payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary or his delegate, and that such regulations shall provide for discounting on the basis of 6-month brackets and shall provide that the present value of any interest payment due not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment. Section 483(c) provides that, except as provided in section 483(f) (relating to exceptions and limitations), section 483 shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract under which some or all of the payments are due more than one year after the date of such sale or exchange, and under which, using a rate provided by regulations (for purposes of section 483(c)(1)(B)), there is total unstated interest. Section 483(c) further provides that any rate prescribed for determining whether there is total unstated interest for purposes of section 483(c)(1)(B) shall be at least one percentage point lower than the rate prescribed for purposes of section 483(b)(2).

(b) *Rate of interest and table of present values for purposes of section 483(c)(1)(B).* For purposes of determining under section 483(c)(1)(B) whether there is total unstated interest under a contract (other than a contract of sale or exchange under which the purchaser is the United States, a State, or any other purchaser described in section 103) which provides for the payment of some interest, a rate of 4 percent per annum simple interest shall be used. As an illustration of the meaning of simple interest, if a contract provides for payments of $6,000 in 3 equal installments of $2,000 plus 4 percent per annum simple interest, such installments of principal and interest being due 1, 2, and 3 years, respectively, from the date of the sale, the amount of interest due with the first installment is $80 ($2,000×0.04×1), the amount of interest due with the second installment is $160 ($2,000×0.04×2), and the amount of interest due with the third installment is $240 ($2,000×0.04×3). Section 483 shall not apply if the interest payments specified in a contract are at a rate of at least 4 percent per annum, whether simple or compounded. In all other cases, for purposes of determining, under section 483(c)(1)(B), whether there is total unstated interest, under a contract (not involving a purchaser

described in section 103), the following table, which provides for discounting payments at a 4 percent per annum simple interest rate, shall be used for computing the present value of a payment to which section 483 applies which is due under the contract, and the present value of any interest payment due under the contract:

PRESENT VALUE OF DEFERRED PAYMENT (4 PERCENT PER ANNUM SIMPLE INTEREST)

Number of months deferred		Present value of $1 at 4% simple interest
At least	But less than	
0	6	1.00000
6	9	.98039
9	15	.96154
15	21	.94340
21	27	.92593
27	33	.90909
33	39	.89286
39	45	.87719
45	51	.86207
51	57	.84746
57	63	.83333
63	69	.81967
69	75	.80645
75	81	.79365
81	87	.78125
87	93	.76923
93	99	.75758
99	105	.74627
105	111	.73529
111	117	.72464
117	123	.71429
123	129	.70423
129	135	.69444
135	141	.68493
141	147	.67568
147	153	.66667
153	159	.65789
159	165	.64935
165	171	.64103
171	177	.63291
177	183	.62500
183	189	.61728
189	195	.60976
195	201	.60241
201	207	.59524
207	213	.58824
213	219	.58140
219	225	.57471
225	231	.56818
231	237	.56180
237	243	.55556
243	249	.54945
249	255	.54348
255	261	.53763
261	267	.53191
267	273	.52632
273	279	.52083
279	285	.51546
285	291	.51020

PRESENT VALUE OF DEFERRED PAYMENT (4 PERCENT PER ANNUM SIMPLE INTEREST)—Continued

Number of months deferred		Present value of $1 at 4% simple interest
At least	But less than	
291	297	.50505
297	303	.50000
303	309	.49505
309	315	.49020
315	321	.48544
321	327	.48077
327	333	.47619
333	339	.47170
339	345	.46729
345	351	.46296
351	357	.45872
357	363	.45455
363	369	.45045
369	375	.44643
375	381	.44248
381	387	.43860
387	393	.43478
393	399	.43103
399	405	.42735
405	411	.42373
411	417	.42017
417	423	.41667
423	429	.41322
429	435	.40984
435	441	.40650
441	447	.40323
447	453	.40000
453	459	.39683
459	465	.39370
465	471	.39063
471	477	.38760
477	483	.38462
483	489	.38168
489	495	.37879
495	501	.37594
501	507	.37313
507	513	.37037
513	519	.36765
519	525	.36496
525	531	.36232
531	537	.35971
537	543	.35714
543	549	.35461
549	555	.35211
555	561	.34965
561	567	.34722
567	573	.34483
573	579	.34247
579	585	.34014
585	591	.33784
591	597	.33557
597	603	.33333
603	609	.33113
609	615	.32895
615	621	.32680
621	627	.32468
627	633	.32258
633	639	.32051

PRESENT VALUE OF DEFERRED PAYMENT (4 PERCENT PER ANNUM SIMPLE INTEREST)—Continued

Number of months deferred		Present value of $1 at 4% simple interest
At least	But less than	
639	645	.31847
645	651	.31646
651	657	.31447
657	663	.31250
663	669	.31056
669	675	.30864
675	681	.30675
681	687	.30488
687	693	.30303
693	699	.30120
699	705	.29940
705	711	.29762
711	717	.29586
717	723	.29412

To compute the present value of a payment, multiply the amount of the payment by the factor contained in the present value column for the appropriate number of months the payment is deferred. For example, the present value of an installment payment of $5,000 due 2 years (24 months) from the date of the sale would be $4,629.65 ($5,000×0.92593).

(c) *Effective date.* The provisions of section 483 and these temporary regulations shall apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963, other than any sale or exchange made pursuant to a binding written contract (including an irrevocable written option) entered into before July 1, 1963.

[T.D. 6720, 29 FR 4882, Apr. 7, 1964]

SUBCHAPTER B—ESTATE AND GIFT TAXES

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

INTRODUCTION

ESTATES OF CITIZENS OR RESIDENTS

TAX IMPOSED

CREDITS AGAINST TAX

GROSS ESTATE

ACTUARIAL TABLES APPLICABLE BEFORE MAY 1, 1989

AUTHORITY: 26 U.S.C. 7805.

Section 20.2031–7 also issued under 26 U.S.C. 7520(c)(2).

Section 20.2031–7A also issued under 26 U.S.C. 7520(c)(2).

Section 20.7520–1 also issued under 26 U.S.C. 7520(c)(2).

Section 20.7520–2 also issued under 26 U.S.C. 7520(c)(2).

Section 20.7520–3 also issued under 26 U.S.C. 7520(c)(2).

Section 20.7520–4 also issued under 26 U.S.C. 7520(c)(2).

SOURCE: T.D. 6296, 23 FR 4529, June 24, 1958; 25 FR 14021, Dec. 31, 1960, unless otherwise noted.

INTRODUCTION

§ 20.0–1 Introduction.

(a) *In general.* (1) The regulations in this part (part 20, subchapter B, chapter I, title 26, Code of Federal Regulations) are designated ''Estate Tax Regulations.'' These regulations pertain to (i) the Federal estate tax imposed by chapter 11 of subtitle B of the Internal Revenue Code on the transfer of estates of decedents dying after August 16, 1954, and (ii) certain related administrative provisions of subtitle F of the Code. It should be noted that the application of many of the provisions of these regulations may be affected by the provisions of an applicable death tax convention with a foreign country. Unless otherwise indicated, references in the regulations to the ''Internal Revenue Code'' or the ''Code'' are references to the Internal Revenue Code of 1954, as amended, and references to a section or other provision of law are references to a section or other provision of the Internal Revenue Code of 1954, as amended. Unless otherwise provided, the Estate Tax Regulations are applicable to the estates of decedents dying after August 16, 1954, and supersede the regulations contained in part 81, subchapter B, chapter I, title 26, *Code of Federal Regulations* (1939) (Regulations 105, Estate Tax), as prescribed and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, signed August 16, 1954 (19 FR 5167, Aug. 17, 1954). The regulations in this part do not reflect the amendments made by the Foreign Investors Tax Act of 1966 (80 Stat. 1539).

(2) Section 2208 makes the provisions of chapter 11 of the Code apply to the transfer of the estates of certain decedents dying after September 2, 1958, who were citizens of the United States and residents of a possession thereof at the time of death. Section 2209 makes the provisions of chapter 11 apply to the transfer of the estates of certain other decedents dying after September 14, 1960, who were citizens of the United States and residents of a possession thereof at the time of death. See §§ 20.2208–1 and 20.2209–1. Except as otherwise provided in §§ 20.2208–1 and 20.2209–1, the provisions of these regulations do not apply to the estates of such decedents.

(b) *Scope of regulations*—(1) *Estates of citizens or residents.* Subchapter A of Chapter 11 of the Code pertains to the taxation of the estate of a person who was a citizen or a resident of the United States at the time of his death. A ''resident'' decedent is a decedent who, at the time of his death, had his domicile in the United States. The term ''United States'', as used in the estate tax regulations, includes only the States and the District of Columbia. The term also includes the Territories of Alaska and Hawaii prior to their admission as States. See section 7701(a)(9). A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal. For the meaning of the term ''citizen of the United States'' as applied in a case where the decedent was a resident of a possession of the United States, see § 20.2208–1. The regulations pursuant to subchapter A are set forth in §§ 20.2001–1 to 20.2056(d)–1.

(2) *Estates of nonresidents not citizens.* Subchapter B of Chapter 11 of the Code pertains to the taxation of the estate of a person who was a nonresident not a citizen of the United States at the time of his death. A ''nonresident'' decedent is a decedent who, at the time of his death, had his domicile outside the United States under the principles set forth in subparagraph (1) of this paragraph. (See, however, section 2202 with respect to missionaries in foreign service.) The regulations pursuant to subchapter B are set forth in §§ 20.2101–1 to 20.2107–1.

(3) *Miscellaneous substantive provisions.* Subchapter C of Chapter 11 of the Code contains a number of miscellaneous substantive provisions. The regulations pursuant to subchapter C are set forth in §§ 20.2201–1 to 20.2209–1.

(4) *Procedure and administration provisions.* Subtitle F of the Internal Revenue Code contains some sections which are applicable to the Federal estate

tax. The regulations pursuant to those sections are set forth in §§ 20.6001–1 to 20.7101–1. Such regulations do not purport to be all the regulations on procedure and administration which are pertinent to estate tax matters. For the remainder of the regulations on procedure and administration which are pertinent to estate tax matters, see part 301 (Regulations on Procedure and Administration) of this chapter.

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than this section and § 20.0–2) is designated by a number composed of the part number followed by a decimal point (20.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 2012 of the Code are designated § 20.2012–1.

[T.D. 6296, 23 FR 4529, June 24, 1958, as amended by T.D. 6526, 26 FR 414, Jan. 19, 1961; T.D. 7238, 37 FR 28717, Dec. 29, 1972; T.D. 7296, 38 FR 34191, Dec. 12, 1973; T.D. 7665, 45 FR 6089, Jan. 25, 1980; T.D. 8522, 59 FR 9646, Mar. 1, 1994]

§ 20.0–2 General description of tax.

(a) *Nature of tax.* The Federal estate tax is neither a property tax nor an inheritance tax. It is a tax imposed upon the transfer of the entire taxable estate and not upon any particular legacy, devise, or distributive share. Escheat of a decedent's property to the State for lack of heirs is a transfer which causes the property to be included in the decedent's gross estate.

(b) *Method of determining tax; estate of citizen or resident*—(1) *In general.* Subparagraphs (2) to (5) of this paragraph contain a general description of the method to be used in determining the Federal estate tax imposed upon the transfer of the estate of a decedent who was a citizen or resident of the United States at the time of his death.

(2) *Gross estate.* The first step in determining the tax is to ascertain the total value of the decedent's gross estate. The value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of his death. (For certain exceptions in the case of real property situated outside the United States, see paragraphs (a) and (c) of § 20.2031–1.) In addition, the gross estate may include property in which the decedent did not have an interest at the time of his death. A decedent's gross estate for Federal estate tax purposes may therefore be very different from the same decedent's estate for local probate purposes. Examples of items which may be included in a decedent's gross estate and not in his probate estate are the following: certain property transferred by the decedent during his lifetime without adequate consideration; property held jointly by the decedent and others; property over which the decedent had a general power of appointment; proceeds of certain policies of insurance on the decedent's life; annuities; and dower or curtesy of a surviving spouse or a statutory estate in lieu thereof. For a detailed explanation of the method of ascertaining the value of the gross estate, see sections 2031 through 2044, and the regulations thereunder.

(3) *Taxable estate.* The second step in determining the tax is to ascertain the value of the decedent's taxable estate. The value of the taxable estate is determined by subtracting from the value of the gross estate the authorized exemption and deductions. Under various conditions and limitations, deductions are allowable for expenses, indebtedness, taxes, losses, charitable transfers, and transfers to a surviving spouse. For a detailed explanation of the method of ascertaining the value of the taxable estate, see sections 2051 through 2056, and the regulations thereunder.

(4) *Gross estate tax.* The third step is the determination of the gross estate tax. This is accomplished by the application of certain rates to the value of the decedent's taxable estate. In this connection, see section 2001 and the regulations thereunder.

(5) *Net estate tax payable.* The final step is the determination of the net estate tax payable. This is done by subtracting from the gross estate tax the authorized credits against tax. Under certain conditions and limitations, credits are allowable for the following (computed in the order stated below):

(i) State death taxes paid in connection with the decedent's estate (section 2011);

(ii) Gift taxes paid on inter-vivos transfers by the decedent of property included in his gross estate (section 2012);

(iii) Foreign death taxes paid in connection with the decedent's estate (section 2014); and

(iv) Federal estate taxes paid on transfers of property to the decedent (section 2013).

Sections 25.2701–5 and 25.2702–6 of this chapter contain rules that provide additional adjustments to mitigate double taxation in cases where the amount of the decedent's gift was previously determined under the special valuation provisions of sections 2701 and 2702. For a detailed explanation of the credits against tax, see sections 201l through 2016 and the regulations thereunder.

(c) *Method of determining tax; estate of nonresident not a citizen.* In general, the method to be used in determining the Federal estate tax imposed upon the transfer of an estate of a decedent who was a nonresident not a citizen of the United States is similar to that described in paragraph (b) of this section with respect to the estate of a citizen or resident. Briefly stated, the steps are as follows: First, ascertain the sum of the value of that part of the decedent's ''entire gross estate'' which at the time of his death was situated in the United States (see §§ 20.2103–1 and 20.2014–1) and, in the case of an estate of an expatriate to which section 2107 applies, any amounts includible in his gross estate under section 2107(b) (see paragraph (b) of § 20.2107–1); second, determine the value of the taxable estate by subtracting from the amount determined under the first step the amount of the allowable deductions (see § 20.2106–1); third, compute the gross estate tax on the taxable estate (see § 20.2106–1); and fourth, subtract from the gross estate tax the total amount of any allowable credits in order to arrive at the net estate tax payable (see § 20.2102–1 and paragraph (c) of § 20.2107–1).

[T.D. 6296, 23 FR 4529, June 24, 1958, as amended by T.D. 6684, 28 FR 11408, Oct. 24, 1963; T.D. 7296, 38 FR 34191, Dec. 12, 1973; T.D. 8395, 57 FR 4254, Feb. 4, 1992]

ESTATES OF CITIZENS OR RESIDENTS

TAX IMPOSED

§ 20.2001–1 Rate of tax.

(a) The gross estate tax is computed by the application of progressively graduated rates to the value of the decedent's taxable estate in accordance with the following table:

TABLE FOR COMPUTATION OF GROSS ESTATE TAX

(A)—Taxable estate equal to or more than—	(B)—Taxable estate less than—	(C)—Tax on amount in column (A)	(D)—Rate of tax on excess over amount in column (A) (percent)
	$5,000	.....	3
$5,000	10,000	$150	7
10,000	20,000	500	11
20,000	30,000	1,600	14
30,000	40,000	3,000	18
40,000	50,000	4,800	22
50,000	60,000	7,000	25
60,000	100,000	9,500	28
100,000	250,000	20,700	30
250,000	500,000	65,700	32
500,000	750,000	145,700	35
750,000	1,000,000	233,200	37
1,000,000	1,250,000	325,700	39
1,250,000	1,500,000	423,200	42
1,500,000	2,000,000	528,200	45
2,000,000	2,500,000	753,200	49
2,500,000	3,000,000	998,200	53
3,000,000	3,500,000	1,263,200	56
3,500,000	4,000,000	1,543,200	59
4,000,000	5,000,000	1,838,200	63
5,000,000	6,000,000	2,468,200	67
6,000,000	7,000,000	3,138,200	70
7,000,000	8,000,000	3,838,200	73
8,000,000	10,000,000	4,568,200	76
10,000,000	.....	6,088,200	77

(b) The application of the table may be illustrated by the following example:

Example. The decedent died January 1, 1955, having a gross estate of $600,000. The exemption and authorized deductions amount to $75,000, thus leaving a taxable estate of $525,000. Reference to the table discloses that the specified amount in column (A) nearest to and less than the value of the decedent's taxable estate is $500,000. The tax upon this amount as indicated in column (C), is $145,700. The amount by which the taxable estate exceeds the same specified amount is $25,000. The tax upon this amount, computed at the rate of 35 percent indicated in column (D), is $8,750. Thus the total gross estate tax upon a taxable estate of $525,000 is $154,450. From this amount, the credits authorized by sections 2011 through 2014 are subtracted in order to determine the net estate tax payable.

§ 20.2002–1 Liability for payment of tax.

The Federal estate tax imposed both with respect to the estates of citizens or residents and with respect to estates of nonresidents not citizens is payable by the executor or administrator of the decedent's estate. This duty applies to the entire tax, regardless of the fact that the gross estate consists in part of property which does not come within the possession of the executor or administrator. If there is no executor or administrator appointed, qualified and acting in the United States, any person in actual or constructive possession of any property of the decedent is required to pay the entire tax to the extent of the value of the property in his possession. See section 2203, defining the term ''executor''. The personal liability of the executor or such other person is described in section 3467 of the Revised Statutes (31 U.S.C. 192) as follows:

> Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

As used in said section, the word ''debt'' includes a beneficiary's distributive share of an estate. Thus, if the executor pays a debt due by the decedent's estate or distributes any portion of the estate before all the estate tax is paid, he is personally liable, to the extent of the payment or distribution, for so much of the estate tax as remains due and unpaid. In addition, section 6324(a)(2) provides that if the estate tax is not paid when due, then the spouse, transferee, trustee (except the trustee of an employee's trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under section 2034 through 2042, is personally liable for the tax to the extent of the value, at the time of the decedent's death, of such property. See also the following related sections of the Internal Revenue Code: Section 2204, discharge of executor from personal liability; section 2205, reimbursement out of estate; sections 2206 and 2207, liability of life insurance beneficiaries and recipients of property over which decedent had power of appointment; sections 6321 through 6325, concerning liens for taxes; and section 6901(a)(1), concerning the liabilities of transferees and fiduciaries.

CREDITS AGAINST TAX

§ 20.2011–1 Credit for State death taxes.

(a) *In general.* A credit is allowed under section 2011 against the Federal estate tax for estate, inheritance, legacy or succession taxes actually paid to any State, Territory, or the District of Columbia, or, in the case of decedents dying before September 3, 1958, any possession of the United States (hereinafter referred to as ''State death taxes''). The credit, however, is allowed only for State death taxes paid (1) with respect to property included in the decedent's gross estate, and (2) with respect to the decedent's estate. The amount of the credit is subject to the limitation described in paragraph (b) of this section. It is subject to further limitations described in § 20.2011–2 if a deduction is allowed under section 2053(d) for State death taxes paid with respect to a charitable gift. See paragraph (a) of § 20.2014–1 as to the allowance of a credit for death taxes paid to a possession of the United States in a case where the decedent died after September 2, 1958.

(b) *Amount of credit.* (1) If the decedent's taxable estate does not exceed $40,000, the credit for State death taxes is zero. If the decedent's taxable estate does exceed $40,000, the credit for State death taxes is limited to an amount computed in accordance with the following table:

TABLE FOR COMPUTATION OF MAXIMUM CREDIT FOR STATE DEATH TAXES

(A)—Taxable estate equal to or more than—	(B)—Taxable estate less than—	(C)—Credit on amount in column (A)	(D)—Rates of credit on excess over amount in column (A) (percent)
$40,000	$90,000	.....	0.8
90,000	140,000	$400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	.....	1,082,800	16.0

(2) Subparagraph (1) of this paragraph may be illustrated by the following example:

Example. (i) The decedent died January 1, 1955, leaving a taxable estate of $150,000. On January 1, 1956, inheritance taxes totaling $2,500 were actually paid to a State with respect to property included in the decedent's gross estate. Reference to the table discloses that the specified amount in column (A) nearest to but less than the value of the decedent's taxable estate is $140,000. The maximum credit in respect of this amount, as indicated in column (C), is $1,200. The amount by which the taxable estate exceeds the same specified amount is $10,000. The maximum credit in respect of this amount, computed at the rate of 2.4 percent indicated in column (D), is $240. Thus, the maximum credit in respect of the decedent's taxable estate of $150,000 is $1,440, even though $2,500 in inheritance taxes was actually paid to the State.

(ii) If, in subdivision (i) of this example, the amount actually paid to the State was $950, the credit for State death taxes would be limited to $950. If, in subdivision (i) of this example, the decedent's taxable estate was $35,000, no credit for State death taxes would be allowed.

(c) *Miscellaneous limitations and conditions to credit*—(1) *Period of limitations.* The credit for State death taxes is limited under section 2011(c) to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the estate tax return for the decedent's estate. If, however, a petition has been filed with the Tax Court of the United States for the redetermination of a deficiency within the time prescribed in section 6213(a), the credit is limited to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the return or within 60 days after the decision of the Tax Court becomes final, whichever period is the last to expire. Similarly, if an extension of time has been granted under section 6161 for payment of the tax shown on the return, or of a deficiency, the credit is limited to those taxes which were actually paid and for which a credit was claimed within four years after the filing of the return, or before the date of the expiration of the period of the extension, whichever period is last to expire. If a claim for refund or credit of an overpayment of the Federal estate tax is filed within the time prescribed in section 6511, the credit for State death taxes is limited to such taxes as were actually paid and credit therefor claimed within four years after the filing of the return or before the expiration of 60 days from the date of mailing by certified or registered mail by the district director to the taxpayer of a notice of disallowance of any part of the claim, or before the expiration of 60 days after a decision by any court of competent jurisdiction becomes final with respect to a timely suit instituted upon the claim, whichever period is the last to expire. See section 2015 for the applicable period of limitations for credit for State death taxes on reversionary or remainder interests if an election is made under section 6163(a) to postpone payment of the estate tax attributable to reversionary or remainder interests. If a claim for refund based on the credit for State death taxes is filed within the applicable period described in this subparagraph, a refund may be made despite the general limitation provisions of sections 6511 and 6512. Any refund based on the credit described in this section shall be made without interest.

(2) *Submission of evidence.* Before the credit for State death taxes is allowed, evidence that such taxes have been paid must be submitted to the district director. The district director may require the submission of a certificate

from the proper officer of the taxing State, Territory, or possession of the United States, or the District of Columbia, showing: (i) The total amount of tax imposed (before adding interest and penalties and before allowing discount); (ii) the amount of any discount allowed; (iii) the amount of any penalties and interest imposed or charged; (iv) the total amount actually paid in cash; and (v) the date or dates of payment. If the amount of these taxes has been redetermined, the amount finally determined should be stated. The required evidence should be filed with the return, but if that is not convenient or possible, then it should be submitted as soon thereafter as practicable. The district director may require the submission of such additional proof as is deemed necessary to establish the right to the credit. For example, he may require the submission of a certificate of the proper officer of the taxing jurisdiction showing (vi) whether a claim for refund of any part of the State death tax is pending and (vii) whether a refund of any part thereof has been authorized, and if a refund has been made, its date and amount, and a description of the property or interest in respect of which the refund was made. The district director may also require an itemized list of the property in respect of which State death taxes were imposed certified by the officer having custody of the records pertaining to those taxes. In addition, he may require the executor to submit a written statement (containing a declaration that it is made under penalties of perjury) stating whether, to his knowledge, any person has instituted litigation or taken an appeal (or contemplates doing so), the final determination of which may affect the amount of those taxes. See section 2016 concerning the redetermination of the estate tax if State death taxes claimed as credit are refunded.

(d) *Definition of ''basic estate tax''.* Section 2011(d) provides definitions of the terms ''basic estate tax'' and ''additional estate tax'', used in the Internal Revenue Code of 1939, and ''estate tax imposed by the Revenue Act of 1926'', for the purpose of supplying a means of computing State death taxes under local statutes using those terms, and for use in determining the exemption provided for in section 2201 for estates of certain members of the Armed Forces. See section 2011(e)(3) for a modification of these definitions if a deduction is allowed under section 2053(d) for State death taxes paid with respect to a charitable gift.

[T.D. 6296, 23 FR 4529, June 24, 1958, as amended by T.D. 6526, 26 FR 414, Jan. 19, 1961]

§ 20.2011–2 Limitation on credit if a deduction for State death taxes is allowed under section 2053(d).

If a deduction is allowed under section 2053(d) for State death taxes paid with respect to a charitable gift, the credit for State death taxes is subject to special limitations. Under these limitations, the credit cannot exceed the least of the following:

(a) The amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d);

(b) The amount indicated in section 2011(b) to be the maximum credit allowable with respect to the decedent's taxable estate; or

(c) An amount, A, which bears the same ratio to B (the amount which would be the maximum credit allowable under section 2011(b) if the deduction under section 2053(d) for State death taxes were not allowed in computing the decedent's taxable estate) as C (the amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d)) bears to D (the total amount of State death taxes paid). For the purpose of this computation, in determining what the decedent's taxable estate would be if the deduction for State death taxes under section 2053(d) were not allowed, adjustment must be made for the decrease in the deduction for charitable gifts under section 2055 or 2106(a)(2) (for estates of nonresidents not citizens) by reason of any increase in Federal estate tax which would be charged against the charitable gifts.

The application of this section may be illustrated by the following example:

Example. The decedent died January 1, 1955, leaving a gross estate of $925,000. Expenses, indebtedness, etc., amounted to $25,000. The decedent bequeathed $400,000 to his son with the direction that the son bear the State

death taxes on the bequest. The residuary estate was left to a charitable organization. Except as noted above, all Federal and State death taxes were payable out of the residuary estate. The State imposed death taxes of $60,000 on the son's bequest and death taxes of $75,000 on the bequest to charity. No death taxes were imposed by a foreign country with respect to any property in the gross estate. The decedent's taxable estate (determined without regard to the limitation imposed by section 2011(e)(2)(B) is computed as follows:

Gross estate				$925,000.00
Expenses, indebtedness, etc.			$25,000.00	
Exemption			60,000.00	
Deduction under section 2053(d)			75,000.00	
Charitable deduction:				
Gross estate		$925,000.00		
Expenses, etc	$25,000.00			
Bequest to son	400,000.00			
State death tax paid from residue	75,000.00			
Federal estate tax paid from residue	122,916.67	622,916.67	302,083.33	462,083.33
Taxable estate				462,916.67

If the deduction under section 2053(d) were not allowed, the decedent's taxable estate would be computed as follows:

Gross estate				$925,000.00
Expenses, indebtedness, etc.			$25,000.00	
Exemption			60,000.00	
Charitable deduction:				
Gross estate		$925,000.00		
Expenses, etc	$25,000.00			
Bequest to son	400,000.00			
State death tax paid from residue	75,000.00			
Federal estate tax paid from residue	155,000.00	655,000.00	270,000.00	355,000.00
Taxable estate				570,000.00

On a taxable estate of $570,000, the maximum credit allowable under section 2011(b) would be $15,200. Under these facts, the credit for State death taxes is determined as follows:

(1) Amount of State death taxes paid other than those for which a deduction is allowed under section 2053(d) ($135,000 – $75,000)	$60,000.00
(2) Amount indicated in section 2011(b) to be the maximum credit allowable with respect to the decedent's taxable estate of $462,916.67	10,916.67
(3) Amount determined by use of the ratio described in paragraph (c) above [($60,000÷$135,000)×$15,200]	6,755.56
(4) Credit for State death taxes (least of subparagraphs (1) through (3) above)	6,755.56

[T.D. 6296, 23 FR 4529, June 24, 1958, as amended by T.D. 6600, 27 FR 4983, May 29, 1962]

§ 20.2012–1 Credit for gift tax.

(a) *In general.* With respect to gifts made before 1977, a credit is allowed under section 2012 against the Federal estate tax for gift tax paid under chapter 12 of the Internal Revenue Code, or corresponding provisions of prior law, on a gift by the decedent of property subsequently included in the decedent's gross estate. The credit is allowable even though the gift tax is paid after the decedent's death and the amount of the gift tax is deductible from the gross estate as a debt of the decedent.

(b) *Limitations on credit.* The credit for gift tax is limited to the smaller of the following amounts:

(1) The amount of gift tax paid on the gift computed as set forth in paragraph (c) of this section, or

(2) The amount of the estate tax attributable to the inclusion of the gift in the gross estate, computed as set forth in paragraph (d) of this section.

When more than one gift is included in the gross estate, a separate computation of the two limitations on the credit is to be made for each gift.

(c) *''First limitation''.* The amount of the gift tax paid on the gift is the ''first limitation''. Thus, if only one gift was made during a certain calendar quarter, or calendar year if the gift was made before January 1, 1971, and the gift is wholly included in the decedent's gross estate for the purpose

of the estate tax, the credit with respect to the gift is limited to the amount of the gift tax paid for that calendar quarter or calendar year. On the other hand, if more than one gift was made during a certain calendar quarter or calendar year, the credit with respect to any such gift which is included in the decedent's gross estate is limited under section 2012(d) to an amount, A, which bears the same ratio to B (the total gift tax paid for that calendar quarter or calendar year) as C (the ''amount of the gift,'' computed as described below) bears to D (the total taxable gifts for the calendar quarter or the calendar year, computed without deduction of the gift tax specific exemption). Stated algebraically, the ''first limitation'' (A) equals:

''Amount of the gift'' (C) ÷ Total taxable gifts, plus specific exemption allowed (D) × Total gift tax paid (B).

For purposes of the ratio stated above, the ''amount of the gift'' referred to as factor ''C'' is the value of the gift reduced by any portion excluded or deducted under sections 2503(b) (annual exclusion), 2522 (charitable deduction), or 2523 (marital deduction) of the Internal Revenue Code or corresponding provisions of prior law. In making the computations described in this paragraph, the values to be used are those finally determined for the purpose of the gift tax, irrespective of the values determined for the purpose of the estate tax. A similar computation is made in case only a portion of any gift is included in the decedent's gross estate. The application of this paragraph may be illustrated by the following example:

Example. The donor made gifts during the calendar year 1955 on which a gift tax was determined as shown below:

Gift of property to son on February 1		$13,000
Gift of property to wife on May 1		86,000
Gift of property to charitable organization on May 15		10,000
Total gifts		109,000
Less exclusions ($3,000 for each gift)		9,000
Total included amount of gifts		100,000
Marital deduction (for gift to wife)	$43,000	
Charitable deduction	7,000	
Specific exemption ($30,000 less $20,000 used in prior years)	10,000	
Total deductions		60,000
Taxable gifts		40,000
Total gift tax paid for calendar year 1955		3,600

The donor's gift to his wife was made in contemplation of death and was thereafter included in his gross estate. Under the ''first limitation'', the credit with respect to that gift cannot exceed:

[$86,000 − $3,000 − $43,000 (gift to wife, less annual exclusion and marital deduction)] ÷ [$40,000 + $10,000 (taxable gifts, plus specific exemption allowed)] × $3,600 (total gift tax paid) = $2,880.

(d) *''Second limitation''.* (1) The amount of the estate tax attributable to the inclusion of the gift in the gross estate is the ''second limitation''. Thus, the credit with respect to any gift of property included in the gross estate is limited to an amount, E, which bears the same ratio to F (the gross estate tax, reduced by any credit for State death taxes under section 2011) as G (the ''value of the gift'', computed as described in subparagraph (2) of this paragraph) bears to H (the value of entire gross estate, reduced by the total deductions allowed under sections 2055 or 2106(a)(2) (charitable deduction) and 2056 (marital deduction)). Stated algebraically, the ''second limitation'' (E) equals:

''Value of the gift'' (G) ÷ Value of gross estate, less marital and charitable deductions (H) × Gross estate tax, less credit for State death taxes (F).

(2) For purposes of the ratio stated in subparagraph (1) of this paragraph, the ''value of the gift'' referred to as factor ''G'' is the value of the property transferred by gift and included in the gross estate, as determined for the purpose of the gift tax or for the purpose of the estate tax, whichever is lower, and adjusted as follows:

(i) The appropriate value is reduced by all or a portion of any annual exclusion allowed for gift tax purposes under section 2503(b) of the Internal Revenue Code or corresponding provisions of prior law. If the gift tax value is lower than the estate tax value, it is reduced by the entire amount of the exclusion. If the estate tax value is lower than the gift tax value, it is reduced by an amount which bears the same ratio to the estate tax value as the annual exclusion bears to the total value of the

property as determined for gift tax purposes. To illustrate: In 1955, a donor, in contemplation of death, transferred certain property to his five children which was valued at $300,000, for the purpose of the gift tax. Thereafter, the same property was included in his gross estate at a value of $270,000. In computing his gift tax, the donor was allowed annual exclusions totalling $15,000. The reduction provided for in this subdivision is:

$15,000 (annual exclusions allowed) ÷ $300,000 (value of transferred property for the purpose of the gift tax) × $270,000 (value of transferred property for the purpose of the estate tax) = $13,500.

(ii) The appropriate value is further reduced if any portion of the value of the property is allowed as a marital deduction under section 2056 or as a charitable deduction under section 2055 or section 2106(a)(2) (for estates of nonresidents not citizens). The amount of the reduction is an amount which bears the same ratio to the value determined under subdivision (i) of this subparagraph as the portion of the property allowed as a marital deduction or as a charitable deduction bears to the total value of the property as determined for the purpose of the estate tax. Thus, if a gift is made solely to the decedent's surviving spouse and is subsequently included in the decedent's gross estate as having been made in contemplation of death, but a marital deduction is allowed under section 2056 for the full value of the gift, no credit for gift tax on the gift will be allowed since the reduction under this subdivision together with the reduction under subdivision (i) of this subparagraph will have the effect of reducing the factor ''G'' of the ratio in subparagraph (1) of this paragraph to zero.

(e) *Credit for ''split gifts''.* If a decedent made a gift of property which is thereafter included in his gross estate, and, under the provisions of section 2513 of the Internal Revenue Code of 1954 or section 1000(f) of the Internal Revenue Code of 1939, the gift was considered as made one-half by the decedent and one-half by his spouse, credit against the estate tax is allowed for the gift tax paid with respect to both halves of the gift. The ''first limitation'' is to be separately computed with respect to each half of the gift in accordance with the principles stated in paragraph (c) of this section. The ''second limitation'' is to be computed with respect to the entire gift in accordance with the principles stated in paragraph (d) of this section. To illustrate: A donor, in contemplation of death, transferred property valued at $106,000 to his son on January 1, 1955, and he and his wife consented that the gift should be considered as made one-half by him and one-half by her. The property was thereafter included in the donor's gross estate. Under the ''first limitation'', the amount of the gift tax of the donor paid with respect to the one-half of the gift considered as made by him is determined to be $11,250, and the amount of the gift tax of his wife paid with respect to the one-half of the gift considered as made by her is determined to be $1,200. Under the ''second limitation'', the amount of the estate tax attributable to the property is determined to be $28,914. Therefore, the credit for gift tax allowed is $12,450 ($11,250 plus $1,200).

[T.D. 6296, 23 FR 4529, June 24, 1958, as amended by T.D. 7238, 37 FR 28718, Dec. 29, 1972; T.D. 8522, 59 FR 9646, Mar. 1, 1994]

§ 20.2013–1 Credit for tax on prior transfers.

(a) *In general.* A credit is allowed under section 2013 against the Federal estate tax imposed on the present decedent's estate for Federal estate tax paid on the transfer of property to the present decedent from a transferor who died within ten years before, or within two years after, the present decedent's death. See § 20.2013–5 for definition of the terms ''property'' and ''transfer''. There is no requirement that the transferred property be identified in the estate of the present decedent or that the property be in existence at the time of the decedent's death. It is sufficient that the transfer of the property was subjected to Federal estate tax in the estate of the transferor and that the transferor died within the prescribed period of time. The executor must submit such proof as may be requested by the district director in order to establish the right of the estate to the credit.

(b) *Limitations on credit.* The credit for tax on prior transfers is limited to the smaller of the following amounts:

(1) The amount of the Federal estate tax attributable to the transferred property in the transferor's estate, computed as set forth in § 20.2013–2; or

(2) The amount of the Federal estate tax attributable to the transferred property in the decedent's estate, computed as set forth in § 20.2013–3.

Rules for valuing property for purposes of the credit are contained in § 20.2013–4.

(c) *Percentage reduction.* If the transferor died within the two years before, or within the two years after, the present decedent's death, the credit is the smaller of the two limitations described in paragraph (b) of this section. If the transferor predeceased the present decedent by more than two years, the credit is a certain percentage of the smaller of the two limitations described in paragraph (b) of this section, determined as follows:

(1) 80 percent, if the transferor died within the third or fourth years preceding the present decedent's death;

(2) 40 percent, if the transferor died within the fifth or sixth years preceding the present decedent's death;

(3) 40 percent, if the transferor died within the seventh or eighth years preceding the present decedent's death; and

(4) 20 percent, if the transferor died within the ninth or tenth years preceding the present decedent's death.

The word ''within'' as used in this paragraph means ''during''. Therefore, if a death occurs on the second anniversary of another death, the first death is considered to have occurred within the two years before the second death. If the credit for tax on prior transfers relates to property received from two or more transferors, the provisions of this paragraph are to be applied separately with respect to the property received from each transferor. See paragraph (d) of example (2) in § 20.2013–6.

(d) *Examples.* For illustrations of the application of this section, see examples (1) and (2) set forth in § 20.2013–6.

§ 20.2013–2 "First limitation".

(a) The amount of the Federal estate tax attributable to the transferred property in the transferor's estate is the ''first limitation.'' Thus, the credit is limited to an amount, A, which bears the same ratio to B (the ''transferor's adjusted Federal estate tax'', computed as described in paragraph (b) of this section) as C (the value of the property transferred (see § 20.2013–4)) bears to D (the ''transferor's adjusted taxable estate'', computed as described in paragraph (c) of this section). Stated algebraically, the ''first limitation'' (A) equals:

Value of transferred property (C) ÷ ''Transferor's adjusted taxable estate'' (D) × ''Transferor's adjusted Federal estate tax'' (B).

(b) For purposes of the ratio stated in paragraph (a) of this section, the ''transferor's adjusted Federal estate tax'' referred to as factor ''B'' is the amount of the Federal estate tax paid with respect to the transferor's estate plus:

(1) Any credit allowed the transferor's estate for gift tax under section 2012, or the corresponding provisions of prior law; and

(2) Any credit allowed the transferor's estate, under section 2013, for tax on prior transfers, but only if the transferor acquired property from a person who died within 10 years before the death of the present decedent.

(c)(1) For purposes of the ratio stated in paragraph (a) of this section, the ''transferor's adjusted taxable estate'' referred to as factor ''D'' is the amount of the transferor's taxable estate (or net estate) decreased by the amount of any ''death taxes'' paid with respect to his gross estate and increased by the amount of the exemption allowed in computing his taxable estate (or net estate). The amount of the transferor's taxable estate (or net estate) is determined in accordance with the provisions of § 20.2051–1 in the case of a citizen or resident of the United States or of § 20.2106–1 in the case of a nonresident not a citizen of the United States (or the corresponding provisions of prior regulations). The term ''death taxes'' means the Federal estate tax

plus all other estate, inheritance, legacy, succession, or similar death taxes imposed by, and paid to, any taxing authority, whether within or without the United States. However, only the net amount of such taxes paid is taken into consideration.

(2) The amount of the exemption depends upon the citizenship and residence of the transferor at the time of his death. Except in the case of a decedent described in section 2209 (relating to certain residents of possessions of the United States who are considered nonresidents not citizens), if the decedent was a citizen or resident of the United States, the exemption is the $60,000 authorized by section 2052 (or the corresponding provisions of prior law). If the decedent was a nonresident not a citizen of the United States, or is considered under section 2209 to have been such a nonresident, the exemption is the $30,000 or $2,000, as the case may be, authorized by section 2106(a)(3) (or the corresponding provisions of prior law), or such larger amount as is authorized by section 2106(a)(3)(B) or may have been allowed as an exemption pursuant to the prorated exemption provisions of an applicable death tax convention. See §20.2052–1 and paragraph (a)(3) of §20.2106–1.

(d) If the credit for tax on prior transfers relates to property received from two or more transferors, the provisions of this section are to be applied separately with respect to the property received from each transferor. See paragraph (b) of example (2) in §20.2013–6.

(e) For illustrations of the application of this section, see examples (1) and (2) set forth in §20.2013–6.

[T.D. 6296, 23 FR 4529, June 24, 1958; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7296, 38 FR 34191, Dec. 12, 1973]

§20.2013–3 "Second limitation".

(a) The amount of the Federal estate tax attributable to the transferred property in the present decedent's estate is the ''second limitation''. Thus, the credit is limited to the difference between—

(1) The net estate tax payable (see paragraph (b)(5) or (c), as the case may be, of §20.0–2) with respect to the present decedent's estate, determined without regard to any credit for tax on prior transfers under section 2013 or any credit for foreign death taxes claimed under the provisions of a death tax convention, and

(2) The net estate tax determined as provided in subparagraph (1) of this paragraph but computed by subtracting from the present decedent's gross estate the value of the property transferred (see §20.2013–4), and by making only the adjustment indicated in paragraph (b) of this section if a charitable deduction is allowable to the estate of the present decedent.

(b) If a charitable deduction is allowable to the estate of the present decedent under the provisions of section 2055 or section 2106 (a)(2) (for estates of nonresidents not citizens), for purposes of determining the tax described in paragraph (a)(2) of this section, the charitable deduction otherwise allowable is reduced by an amount, E, which bears the same ratio to F (the charitable deduction otherwise allowable) as G (the value of the transferred property (see §20.2013–4)) bears to H (the value of the present decedent's gross estate reduced by the amount of the deductions for expenses, indebtedness, taxes, losses, etc., allowed under the provisions of sections 2053 and 2054 or section 2106(a)(1) (for estates of nonresidents not citizens)). See paragraph (c)(2) of example (1) and paragraph (c)(2) of example (2) in §20.2013–6.

(c) If the credit for tax on prior transfers relates to property received from two or more transferors, the property received from all transferors is aggregated in determining the limitation on credit under this section (the ''second limitation''). However, the limitation so determined is apportioned to the property received from each transferor in the ratio that the property received from each transferor bears to the total property received from all transferors. See paragraph (c) of example (2) in §20.2013–6.

(d) For illustrations of the application of this section, see examples (1) and (2) set forth in §20.2013–6.

[T.D. 6296, 23 FR 4529, June 24, 1958; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7296, 38 FR 34191, Dec. 12, 1973]